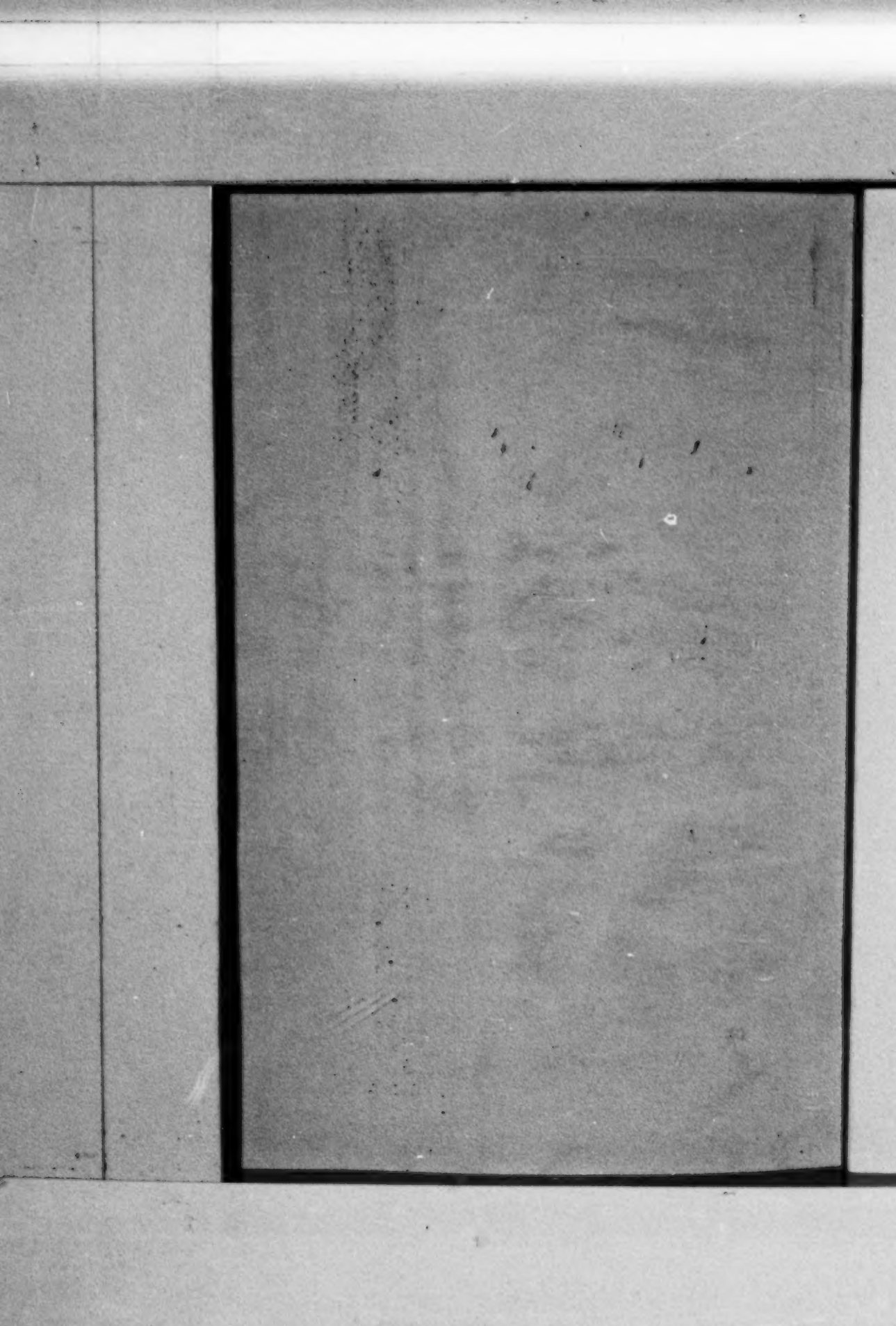

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IN THE

Supreme Court of the United States

October Term, 1973.

No. 73-241.

CHICAGO MERCANTILE EXCHANGE,
Petitioner,

v.

DARRYL B. DEAKTOR,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

AARON M. FINE,
JACK JOSEPH,
ARTHUR M. KAPLAN,
Attorneys for Respondent.

Of Counsel:
HAROLD E. KOHN, P. A., Attorneys at Law,
1214 IVB Building,
1700 Market Street,
Philadelphia, Pennsylvania. 19103

JOSEPH & FRIEDMAN,
69 West Washington Street,
Chicago, Illinois. 60602

International Printing Co., 711 So. 8th St., Phila., Pa. 19147 — Tel. (215) 727-0711

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I. STATEMENT OF THE CASE.

The Deaktor complaint alleges that those defendants who are members of the Chicago Mercantile Exchange (Exchange or CME) manipulated and cornered the market in July, 1970 frozen pork bellies futures contracts traded on the Exchange, forcing up the price of those contracts and injuring traders who, like the plaintiff, sold short and had not liquidated their positions before the defendants' manipulation took effect, so that they were required to cover their positions by purchasing contracts at prices inflated by the defendants' illegal actions.

The complaint also alleges that the Exchange itself, which is a designated contract market under the Commodity Exchange Act (the Act), 7 U. S. C. §7 knew, or should have known, of the unlawful activities of the other defendants and failed to act promptly to stop those activities, and failed thereby to comply with its own Rules and the Act to the injury of the plaintiff and other class members. The plaintiff has sued on his own behalf, and, under F. R. C. P. 23, on behalf of all others similarly situated.

In prior proceedings, hearings were held before the Board of Governors of the Exchange, beginning on September 3, 1970 and concluding on October 6, 1970, on charges brought by the Exchange itself relating to the July, 1970 pork bellies contracts. The transcript covers more than 2800 pages. In those proceedings, Exchange members who are defendants herein were charged with violations of rules of the Exchange. Ultimately, they pleaded guilty or *nolo contendere* to violation of certain rules. Certain of the defendants were adjudged guilty of violations constituting major offenses under the rules of the Exchange and were punished by fine, suspension, or both. Prosecution of the charges before the Exchange was conducted by counsel for the Exchange, who submitted in his opening at the hearings before the Board of Governors that:

". . . we go further and we charge here that there has been a concerted group action which attempted to corner and manipulate the market, that this concerted action was accompanied by and was characterized by violations of these specific Rules to which I have just alluded, that we will establish by documents and oral testimony the substance of our charges that the Board can, in the exercise of its judgment and discretion, and solely on the basis of that evidence prosecuted, pass upon the charges. We think that there has been a sham, a phony or fictitious, very substantial sale or announced sale of a very large quantity of pork bellies in the midst of this scheme and operation. We will demonstrate the extent to which that particular transaction which was widely publicized throughout the country was a sham. This publicizing of a sale constituted the issuance of false information, which is a very grievous offense in our marketplace, as you all know." (39A-40A, CA).[1]

In support of its charges the Exchange called W. M. Phelan, its vice president in charge of Audit and Investigations. He testified that there had been, in his opinion, a manipulation of the July market; that his personal observations had led to that conclusion prior to July, 1970, and as early as May, 1970; and that he had ". . . received constant complaints from the public, phone calls were coming in from all over the country which I received, questioning what we were doing about it." (41A-42A, CA).

In the District Court, certain of the Exchange member defendants, and the Exchange, moved for a stay of proceedings on the ground that the plaintiff should be required

1. References bearing the notation CA are to page numbers in the Appendix filed in the Court of Appeals. All other references are to page numbers in the Appendix to the Petition for Certiorari.

to seek redress in the first instance before the Commodity Exchange Commission. On August 23, 1971, Judge Perry denied the motions in a minute order reciting that they "are not supported in law." On October 14, 1971, on application of the Exchange he amended his order certifying it for interlocutory appeal under 28 U. S. C. § 1292(b). The Court of Appeals for the Seventh Circuit accepted the appeals on January 10, 1972, and on May 21, 1973 rendered its opinion, and concurrence, unanimously affirming the order of the district court. (1a, et seq.)[2] The Court of Appeals considered at length the pertinent decisions of this Court, including *Ricci v. Chicago Mercantile Exchange*, 409 U. S. 289 (1973), and concluded that, "the district court was correct in refusing to stay proceedings" in this case in order to refer matters to the Commodity Exchange Commission. The Court found that:

> 1. In this action, unlike *Ricci*, "the district court is not being asked to reconcile the possibly conflicting policies of two congressional acts". The Complaint in *Deaktor* contains no second antitrust cause of action.
>
> 2. The district court is not being called upon to determine the legality of rules of the Exchange. 7 U. S. C. § 7a(8) requires the Exchange to enforce all Exchange bylaws, rules, and regulations, which have not been disapproved by the Secretary of Agriculture. Exchange Rule 217(C) provides that the Exchange's Business Conduct Committee "be charged with the duty and authority to prevent manipulation" and Exchange Rule 217(D) gives the Business Conduct Committee authority to fulfill that duty through investigation of the financial transactions of members, to

2. Only the Exchange itself and one member defendant appealed. The other member defendants did not appeal.

examine their books, and to issue cease and desist orders, after notice and hearing to members found to be engaging in conduct which is "unfair or unjust".

3. The particular conduct alleged is not arguably protected by other rules of the Exchange, or by provisions of the Commodity Exchange Act.

4. As primary jurisdiction, rather than exclusive jurisdiction, is alleged by appellants (petitioners herein), the courts would have to in the final event hear the questions.

5. The issues of manipulation involved are not different in difficulty or kind from those ordinarily determined by the courts in the first instance in other private damage actions, including securities litigation.

Senior Circuit Judge Castle concurred in the result on the following, related grounds:

1. "Since the Exchange Act does not in any way give a commodities exchange or the Commission power to sanction price manipulation, and since, for reasons to be discussed below, deference to administrative expertise is not vital for defining the scope of the regulations governing the issues raised by the complaints, I do not believe that *Ricci* compels deference to administrative primary jurisdiction in these cases."

2. "Courts have usually invoked the doctrine of primary jurisdiction where they have determined that the issues raised are within the unique expertise of administrative agencies, where the issues involve administrative discretion, and where the desire for uniformity would be frustrated by many courts reaching inconsistent decisions."

3. "Given the unobtrusive nature of the facts at issue in these cases, I doubt whether deference to the

Commission would add substantially to their resolution. These facts do not involve a pervasive regulatory scheme, *United States v. Radio Corporation of America*, 358 U. S. 334, 350 (1950), or matters within administrative discretion, *Great Northern Ry. v. Merchants Elevator Co.*, 259 U. S. 285, 294 (1922), but rather a unique set of facts concerning situations which may never be repeated."

4. "The main issue common to all these appeals —i.e., whether a manipulation of prices occurred—is one which the judiciary has considered itself just as competent as the Commodities Exchange Commission to pass upon. Since the term manipulation is undefined in the Act, courts of appeal have given it meaning in the cases taken on direct appeal from Commission determinations. *Volkart Brothers Inc. v. Freeman*, 311 F. 2d 52, 58 (5th Cir. 1962); *General Foods Corp. v. Brannan*, 170 F. 2d 220, 223-24 (7th Cir. 1948)."

5. "Finally, the interest of the plaintiffs in these cases should be considered. Any deference to administrative primary jurisdiction and subsequent appeals from administrative decisions before a district court adjudication of their complaints will increase costs, delay redress of any wrongs, and act to deter litigation."

Appellants, including the Petitioner herein, petitioned for a rehearing, including suggestion of a rehearing *en banc*. On June 26, 1972 the petition was denied, "no judge in active service having requested a vote thereon, nor any judge [having] voted to grant the suggestion." (20a) Only the Exchange has petitioned this Court for a writ of certiorari.

II. REASONS FOR DENYING THE WRIT.

A. There Is No Conflict With This Court's Decision in Ricci v. Chicago Mercantile Exchange.

Petitioner misconceives the scope of this Court's holding in *Ricci v. Chicago Mercantile Exchange*, 409 U. S. 289 (1973) urging, in effect, that every case in which the Chicago Mercantile Exchange (or any other commodities exchange) is a party, must by reason of that fact alone be referred to the Commodity Exchange Commission in the first instance. Petitioner's argument both misconstrues *Ricci*, and misperceives the role of the Exchange in this litigation. For the Exchange is, primarily, charged with a violation of its own rules, which it is under a clear duty to enforce. In that respect it stands on equal footing with other parties charged with Exchange rule violations.

The Court of Appeals found, and it is not disputed, that:

> ". . . the Chicago Mercantile Exchange Rule 217(C) provided that the Business Conduct Committee be charged with the duty and authority to prevent manipulation of prices and the cornering of any commodity. Rule 217(D) gives the Business Conduct Committee authority to investigate the transactions and financial condition of members, to examine their books, to prescribe capital requirements, and to issue cease and desist orders, after notice and hearing, to members found to be engaging in conduct which is 'unfair or unjust'." (3a-4a)

It is also without dispute, as found by the Court of Appeals, that: "In order to qualify as a contract market, the Chicago Mercantile Exchange was required to file with the

Secretary its rules, regulations and by-laws, including rules 'for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board'." 7 U. S. C. §7(d). (3a) The Exchange is required by 7 U. S. C. §7a(8) in addition, to "enforce all by-laws, rules, regulations, and resolutions, made or issued by it or by the governing board thereof or any committee, which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market, or relate to other trading requirements, and which have not been disapproved by the Secretary of Agriculture. . . ." (3a)

Ricci, by questioning whether loss of Exchange membership violated Exchange rules or was permitted or protected by them, raised complicated and substantial questions concerning the scope and purpose of the rules. (6a) The Court of Appeals rightly found no such issue herein. (3a, 6a-8a and concurrence at 15a-17a). The Exchange, quite simply, was required to enact rules to prevent manipulation, did enact such rules, and was under a statutory duty to enforce its rules. No complicated problem of reconciling potentially conflicting statutory policies of the Commodities Exchange Act and the antitrust laws is here involved, as it was in *Ricci*. Nor is the legality of any Exchange rule here questioned, as it was in *Ricci*. As stated in Judge Castle's concurrence herein:

> "Given the unobstrusive nature of the facts at issue in these cases, I doubt whether deference to the Commission would add substantially to their resolution. These facts do not involve a pervasive regulatory scheme, *United States v. Radio Corporation of America*, 358 U. S. 332, 350 (1959), or matters within administrative discretion, *Great Northern Ry. v. Merchants Elevator Co.*, 259 U. S. 285, 294 (1922), but

rather a unique set of facts concerning situations which may never be repeated. The main issue common to all these appeals—i.e., whether a manipulation of prices occurred—is one which the judiciary has considered itself just as competent as the Commodity Exchange Commission to pass upon. Since the term manipulation is undefined in the Act, courts of appeal have given it meaning in the cases taken on direct appeal from commission determinations. *Volkart Brothers, Inc. v. Freeman*, 311 F. 2d 52, 58 (5th Cir. 1962), *General Foods Corp. v. Brannan*, 170 F. 2d 220, 223-24 (7th Cir. 1948) . . . In short, it is doubtful that deference can add much to the work of a court and jury in resolving the issues concerning manipulation in the instant cases, . . . " (17a, 18a)

The problem in *Ricci*, as this Court stated, "arises when conduct seemingly within the reach of the antitrust laws is also at least arguably protected or prohibited by another regulatory statute enacted by Congress." 409 U. S. at 299-300. There is no antitrust claim in the *Deaktor* action. The only claims alleged arise under the Commodities Exchange Act, and as the Court of Appeals found, the Act clearly and forthrightly requires the Exchange to enact rules and to enforce its rules, "for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board." 7 U. S. C. §7(d) and 7 U. S. C. §7a(8). The violations of the Act and rules thereunder are not arguably protected by "another regulatory statute enacted by Congress," as in *Ricci*.

Indeed, the Petition for Certiorari concedes in regard to the *Phillips* case,[3] in which certiorari is also sought, that §7(a)8 of the Commodities Exchange Act "requires CME

3. Unlike *Deaktor*, *Phillips* does involve antitrust claims.

to adopt rules and exercise self-regulatory powers to prevent manipulation." (Petition at 6)

Only where referral to an administrative proceeding is "likely to make meaningful contribution" to the resolution of a lawsuit is the application of primary jurisdiction in order. *Ricci, supra*, 409 U. S. at 306-307.

No "meaningful contribution" is likely where the Exchange is charged with a violation of its rules for the prevention of manipulation, which it is under a clear duty to enforce, and where no countervailing Exchange rule or statutory provision can be seriously claimed to immunize the violation of the rules.[4] After measuring the allegations (and the evidence in the prior CME proceedings) against the principles of law involved, the district court and a unanimous panel of the Court of Appeals concluded that administrative referral and a stay of court proceedings were not likely to produce the requisite "meaningful contribution"; and not a single judge of the Seventh Circuit felt that reconsideration was required by the facts of this case.

B. There Is No Conflict With the Seventh Circuit's Decision in Ricci v. Chicago Mercantile Exchange.

Curiously, the Petition alleges that the decision of the Court of Appeals for the Seventh Circuit herein conflicts with the decision rendered by the same Circuit in *Ricci v. Chicago Mercantile Exchange*, 447 F. 2d 713 (7th Cir.

4. Compare Judge Castle's unassailable finding regarding immunization of manipulation:

> ". . . [T]he Exchange Act does not in any way give a commodities exchange or the Commission power to sanction price manipulation . . . ." (15a)

to the situation in *Ricci*:

> "The Act clearly contemplates a membership organization and hence the existence of criteria for the acquisition, transfer, and loss of membership." 409 U. S. at 303.

1971), prior to review by this Court. The petition cites the Court of Appeals' conclusion that the questions in *Ricci* "are precisely the ones that the Commission and the Secretary are to resolve." There is no reason to believe that the Court of Appeals for the Seventh Circuit gave less consideration to the nature of the questions involved herein, than it did in *Ricci*. It is the questions involved which differ entirely, rather than the quality of review.

This makeshift "conflict" is belied by the order of the Seventh Circuit denying rehearing. Not a single judge favored a rehearing *en banc*. Furthermore, the Seventh Circuit's construction of *Ricci* herein, comports with the reasonable construction of that decision in districts outside the Seventh Circuit. In *Seligson v. New York Produce Exchange, et al.*, 1973 CCH Trade Cases ¶ 74,620 (S. D. N. Y. 1973), the district court noted that:

> "In discussing the first of its three premises for referral to the Commodity Exchange Commission, the Supreme Court noted that if the challenged membership transfer was made in accordance with a valid Exchange rule:
>
> > 'the immediate question for the antitrust court is whether the rule itself and Ricci's exclusion under it are insulated from antitrust attack.' (93 S. Ct. at 581).
>
> It is evident, therefore, that the Court based its application of the doctrine of primary jurisdiction on the possibility that conduct alleged as violative of the antitrust laws was authorized by the Commodity Exchange Act and immune, by virtue of that authorization, from antitrust attack. As a consequence, it would appear that where a complaint alleges conduct . . . which is clearly violative of the [Commodity Exchange] Act and outside the scope of any authority

granted to the defendant exchange members, referral to the Commission would not be, in the language of the Court's third premise, 'of material aid . . .'."

See also *Aloha Airlines, Inc. v. Hawaiian Airlines, Inc.*, 1973 CCH Trade Cases ¶ 74,393 (D. Hawaii 1973).

CONCLUSION.

For the reasons stated, the Petition for Certiorari should be denied.

Respectfully submitted,

AARON M. FINE,
JACK JOSEPH,
ARTHUR M. KAPLAN,
Attorneys for Respondent.

Of Counsel:
HAROLD E. KOHN, P. A.,
Attorneys At Law,
1214 IVB Building,
1700 Market Street,
Philadelphia, Pennsylvania. 19103

JOSEPH & FRIEDMAN,
69 West Washington Street,
Chicago, Illonis. 60602